FILE COPY

FILED
MAY 24 1960
JAMES R. BROWNING, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1959.

No. 890

BOWERS MANUFACTURING CO., INC.,

Petitioner,

vs.

ALL-STEEL EQUIPMENT INC.,

Respondent.

RESPONSE TO PETITION FOR WRIT OF CERTIORARI.

THOMAS F. McWILLIAMS
53 W. Jackson Blvd.
Chicago 4, Illinois
Attorney for Respondent

The Scheffer Press, Inc.—ANdover 3-6850

INDEX

PAGE

Statement of Fact 1

Question Presented 4

Argument 5

1. The Decision of the Court of Appeals in this Case is in Harmony with the Decision of this Court and with the Decisions of Other Courts of Appeal. There is no Basic Conflict of Decision. 9

2. The Opinion Below is not in Conflict with Applicable State Law. 13

Conclusion 15

Authorities Cited

Air King Products Co. v. Hazeltine Research, E.D. N.Y. 1950, 94 Fed. Supp. 85, 87 U.S.P.Q. 315 11

Automatic Radio Mfg. Co., Inc. v. Hazeltine Research, Inc., 176 F.2d 799 (C.A. 1, 1949; affirmed 339 U.S. 827) 6, 8, 9

Dall Motor Parts Co. v. Packard, 1931, 124 Ohio St. 363, 178 N.Ed. 835, 12 U.S.P.Q. 185 11

Del Riccio et al. v. Photochart, 268 P.2d 814 14

Eastern States Petroleum Co. v. Universal Oil Co., 1938, 22 Del. Ch. 333, 2 A.2d 138, 37 U.S.P.Q. 834 11

Hall Laboratories v. National Aluminate Corp., 120 F.Supp. 684, 224 F.2d 303 13

Hardwick v. Gailbraith, 147 Pa. 333 ..... 11, 13

Hazeltine Research v. DeWald (1st Dept. 1950), 276 App. Div. 1001, 95 N.Y.S. 2d 772; 85 U.S.P.Q. 222, reversing 84 N.Y.S. 2d 597, 79 U.S.P.Q. 446 11

PAGE

Heath v. A. B. Dick Co., 253 F.2d 30 (C.A. 7, 1958) 10

Heller Inc. v. Lassner Co. (1st Dept. 1925), 214 App. Div. 315; 212 N.Y. Supp. 175 11

Hennessy v. Bacon, 137 U.S. 78, 85 (1890) 5

Jungersen v. Morris Kaysen (Pa. C.P. 1952) 95 U.S.P.Q. 162, aff'd 173 Pa. Super. 114, 97 U.S.P.Q. 244 (1953) 11, 13

Lehman Co. v. Appleton Toy & Furniture Co. (C.A. 7, 1945), 148 F.2d 988 13

Muth v. J. W. Speaker Corporation (C.A. 7, 1959), 262 F.2d 797, 801 16

Pope Mfg. Co. v. Owsley (C.C. N.D. Ill., 1886), 27 F. 100 13

St. Paul Plow Works v. Starling, 140 U.S. 184, 195, 35 L.Ed. 404, 407 (1891) 9

Universal Rim Co. v. Scott, N.D. Ohio E.D., 1922, 21 F.2d 346 12

Vicki Hosiery v. Margulies, E.D. Pa., 1958, 164 Fed. Supp. 738 12

Washburn & Moen Mfg. Co. v. Cincinnati Barbed-Wire Fence (C.C.S.D. Ohio, 1884), 22 Fed. 712 11

Williams v. First National Bank, 216 U.S. 582, 595 (1910) 5

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1959.

No. 890

BOWERS MANUFACTURING CO., INC.,

Petitioner,

vs.

ALL-STEEL EQUIPMENT INC.,

Respondent.

RESPONSE TO PETITION FOR WRIT OF CERTIORARI.

STATEMENT OF FACT.

By its decision below, the Court of Appeals for the Ninth Circuit affirmed the judgment of the District Court (R 114), which entered judgment against Petitioner in the amount of approximately $12,000.00 and by a mandatory injunction required Petitioner to make royalty reports and payments provided for in a patent license agreement between Petitioner and Respondent.

The judgment was based upon Findings of Fact and Conclusions of Law (R 110-114) finding that on January 1, 1955, Petitioner and Respondent entered into a nonexclusive patent license agreement by which Petitioner became obligated to pay royalties for its production and sale of cable clamps covered by Patent No. 2,424,829; that Petitioner had paid royalties under the agreement for a time but had ceased paying royalties, although it admitted it had produced cable clamps covered by Patent

No. 2,424,829; that the agreement was still in effect, and that royalties should be paid by Petitioner to Respondent. The Court concluded as a matter of law that Petitioner's attempt to terminate the agreement by a simple notice of termination was not legally sufficient to effectuate a termination.

A brief statement of the facts leading up to the execution of the license agreement and reference to a few pertinent terms of the agreement will facilitate an understanding of the simple principle of contract law which determines Petitioner's contractual liability.

Respondent, the owner of Patent No. 2,424,829 by letter (R 21) charged Petitioner with infringement of the patent, and by letter (R 23) Petitioner responded, stating that it had no deliberate intention to infringe. Petitioner subsequently (R 24) by letter conceded that the products made by it were fully covered by Respondent's patent and suggested a settlement of the controversy by the grant of a license. The parties by letters (R 25-28) negotiated the terms to be incorporated in the proposed license agreement, and an agreement (R 30) was submitted to Petitioner for execution. Further negotiations in the form of a letter (R 34) from Petitioner to Respondent occurred, and a revised agreement was submitted (R 36), which was accepted by Respondent.

The agreement provided for the grant of a non-exclusive license under Patent No. 2,424,829 to Petitioner, which license was to extend for the full term of the patent. Petitioner was to pay a royalty of one per cent of the net sale price of all switch and outlet boxes including cable clamps covered by Patent No. 2,424,829, with payments to be made yearly. A significant portion of the agreement provided that Petitioner should have the right to cancel

the non-exclusive license agreement only in the event that:

(a) The licensed patent was held invalid by a court of competent jurisdiction from which no appeal was taken; or

(b) Petitioner completely discontinued the manufacture and sale of boxes embodying cable clamps covered by Patent No. 2,424,829 (R 38).

Upon the execution of the license agreement, Petitioner paid to Respondent $1,108.00 as royalties for infringing production during 1954, and under the terms of the license Petitioner paid $3,594.00 as royalties for production during the year 1955.

Petitioner concedes (R 56-59, R 101-105) that during the years 1956, '57 and '58 it made and sold switch or outlet boxes including cable clamps covered by Patent No. 2,424,829 having a total sales price in excess of $1,107,000.00 upon which royalties were not paid. The royalty rate being one per cent, as provided in the agreement, the royalties approximate $11,000.00.

Upon Petitioner's continued refusal to submit royalty reports and make royalty payments, this action was commenced in the District Court to collect the amounts due under the license agreement and for specific performance to compel Petitioner to adhere to the terms of the license agreement. In the District Court, Petitioner pleaded termination of the license agreement by its unilateral notice of termination (R 81-84).

A motion was filed in the District Court to strike certain portions of Defendant's answer pleading unilateral termination, and to dismiss counterclaims for a declaration of invalidity and for recovery of royalties predicated solely upon the asserted termination. The District Court

held that the attempted termination or repudiation of the license agreement was not legally effected; that the defenses and counterclaims were therefore legally insufficient; and, finding (R 114) that Petitioner had no defense to the complaint other than that set forth in the stricken paragraphs, entered judgment.

There is no dispute as to any of the facts found by the District Court. The only question presented is a simple question of contract law.

QUESTION PRESENTED.

The question of law presented in the petition for certiorari should be stated as follows: May a nonexclusive licensee by a simple notice of termination effectively terminate a license agreement contrary to the terms thereof?

ARGUMENT.

The facts establish that when Petitioner conceded the infringement of Respondent's patent, prospective litigation was imminent. The parties in lieu of litigation compromised the controversy by the execution of the license agreement. Petitioner is not contending that any undue advantage was taken of it during the negotiations, and does not assert that the agreement was in any respect illegal. The agreement was legal when executed, and Petitioner's only excuse for repudiation was its after-acquired observation that the patent under which it had a nonexclusive license might be invalid. Such assumed invalidity is asserted to avoid its contractual obligation to pay royalties. Nevertheless, it is abundantly clear that the agreement between Petitioner and Respondent was executed to settle prospective patent litigation.

In *Williams* v. *First National Bank*, 216 U.S. 582, 595 (1910), this Court stated:

> "Compromises of disputed claims are favored by the courts * * *; and presumptively, the parties to the compromise in question possessed the right to thus adjust their differences. * *"

In a situation where one of the parties asserted that it had made a bad bargain this Court, in *Hennessy* v. *Bacon*, 137 U.S. 78, 85 (1890), stated:

> "* * * It was a case of the compromise of a disputed claim, the parties dealing with each other upon terms of perfect equality, holding no relations of trust or confidence to each other, and each having knowledge, or having the opportunity to acquire knowledge, of every fact bearing upon the question of the validity

> of their respective claims. • • • Such a settlement ought not to be overthrown, even if the court should now be of opinion that the party complaining of it surrendered rights that the law, if appealed to, would have sustained. • • •".

In *Automatic Radio Mfg. Co., Inc.* v. *Hazeltine Research, Inc.*, 176 F.2d 799, 806 (affirmed 339 U.S. 827), the Court of Appeals for the 1st Circuit stated:

> "• • • It is not uncommon for the parties to a patent infringement suit, in which there is a genuine issue as to the validity of the patent, to make a settlement of the litigation by an agreement under which the patentee gives a license to the alleged infringer in consideration of the payment of a stipulated royalty. Indeed, the license agreement in suit seems to have been by way of settlement of earlier litigation between the parties. It is not apparent to us that the public interest would be served by rendering such common-sense business settlements nugatory, which would be the result of a ruling that the licensee could reopen the issue of validity when sued for the stipulated royalty."

In its opinion below, the Court of Appeals in the instant case stated:

> "General policy considerations favoring settlement of disputes and litigation by means of such nonexclusive licenses should not allow a licensee to attack the validity of a licensor's patent by means of a device such as prior rescission, anymore than by direct attack through a suit for royalties. The licensee has bought temporary peace by agreeing to the license, and should be required to abide by his bargain. • • •"

Petitioner argues that the law should be that a nonexclusive licensee by simple unilateral notice of repudiation, because of alleged patent invalidity, may effectively

terminate a license agreement and thereafter in any suit on the contract plead invalidity of the patent.

By the nonexclusive license, Petitioner acquired only the right to be freed from a suit for patent infringement under the licensed patent. As a nonexclusive licensee, Petitioner did not acquire any monopoly or any exclusivity. After the grant of the license, Petitioner was still subject to competition in the sale of products covered by the licensed patent from Respondent and from any and all other companies whom Respondent might license. Petitioner argues that whenever it concluded that the licensed patent might be invalid it had the right to terminate the agreement because there was a failure of consideration.

It is important to note the difference between a nonexclusive and an exclusive license. This distinction was recognized by the Court of Appeals below when it stated:

> "* * * Whether it is exclusive or nonexclusive is usually ascertained by some chance remark of the court. Cases dealing with both types of licenses are cited indiscriminately. But logic would indicate that a different treatment is justified. The two types of agreements differ basically because the consideration inducing them differs in each. In an exclusive license the monopoly values of the patent loom large. The license is in effect a grant of the patent. But a nonexclusive license cannot eliminate competition. It constitutes little more than a shield from suit for infringement by the grantor. Thus questionable validity of the patent cannot constitute a failure of consideration."

In essence, the judgment of the District Court found that Petitioner's attempt at unilateral repudiation of the nonexclusive license agreement was ineffective to terminate the agreement; that the agreement was still in effect, and therefore Petitioner, a licensee, was estopped to contest

the validity of the licensed patent. Petitioner does not question the doctrine of licensee estoppel. Such a position would be directly contrary to the opinion of this Court in *Automatic Radio Mfg. Co., Inc.* v. *Hazeltine Research, Inc.*, 339 U.S. 827, wherein this Court stated:

> "• • • Finally it is contended that notwithstanding the licensing agreement, petitioner-licensee may contest the validity of the patents it is charged with using. The general rule is that the licensee under a patent license agreement may not challenge the validity of the licensed patent in a suit for royalties due under the contract. *United States* v. *Harvey Steel Co.*, 196 US 310, 49 L. ed 492, 25 S Ct 240. • • •"

In order for Petitioner to be in a position to challenge the validity of the licensed patent, it must effect a repudiation or termination of the license agreement. Unless the contract provides for termination by the licensee, there is no escape. The contract provided that it would run until the expiration of Patent No. 2,424,829, an event which does not occur until 1964.

Specific provisions permitting relief from the payment of royalties were included in the agreement, one of these being in the event that the patent was held invalid in third party litigation, and the other in the event that Petitioner ceased manufacturing any items covered by the patent in suit. The patent has never been held invalid in any third party litigation, and Petitioner concedes that it has continued the manufacture of switch or outlet boxes including cable clamps covered by the licensed patent.

Petitioner urges two grounds for the grant of certiorari. These grounds shall be hereinafter discussed under appropriate headings.

1. THE DECISION OF THE COURT OF APPEALS IN THIS CASE IS IN HARMONY WITH THE DECISION OF THIS COURT AND WITH THE DECISIONS OF OTHER COURTS OF APPEAL. THERE IS NO BASIC CONFLICT OF DECISION.

Petitioner urges that a nonexclusive licensee may be permitted by notice to terminate a license agreement entered into in settlement of a controversy, even where such attempted termination is contrary to the specific terms of the agreement.

In *St. Paul Plow Works* v. *Starling*, 140 U.S. 184, 195, 35 L.Ed. 404, 407 (1891), this Court stated:

> "* * * we are of opinion that the circuit court was correct in holding that the defendant could not terminate, without the consent of the plaintiff, the rights conferred by the license, and that, as there was no limitation on its face, the license continued until the expiration of the patent. The contract has no provision for its termination or its renunciation.
>
> * * *
>
> "We are of opinion that the license, in the absence of a stipulation providing for its revocation, was not revocable by the defendant, except by mutual consent or by the fault of the other party. * * *
>
> "The defendant could not coerce the plaintiff into putting an end to the contract, by the means it adopted. * * *"

In *Automatic Radio Mfg. Co.* v. *Hazeltine Research, Inc.*, 176 F.2d 799 (C.A. 1, 1949; affirmed 339 U.S. 827), the Court of Appeals for the 1st Circuit stated:

> "* * * In addition to that, so far as it may be a question of federal law, in the absence of a cancellation option in the agreement, or of a substantial default by the licensor, the licensee cannot by any such unilateral notice of repudiation terminate its contract

obligation under a license agreement having several years yet to run. *St. Paul Plow Works* v. *Starling*, 1891, 140 U.S. 184, 11 S.Ct. 803, 35 L.Ed. 404; * * * (page 809)

In *Heath* v. *A. B. Dick Co.*, 253 F.2d 30 (C.A. 7, 1958), the Court of Appeals for the 7th Circuit stated:

"* * * The execution of the license agreement and the subsequent payment of royalties thereunder for about five years indicate that defendant, fully aware of its legal rights and on its own initiative, procured from plaintiff the right to make and market its stencil assembly. Defendant makes no charge of deception, fraud, or coercion on the part of plaintiff surrounding the execution of the agreement. Defendant's general counsel was evidently convinced that, to avoid liability as an infringer, or at least to avoid litigation involving a charge of infringement, it was good business for defendant to procure the license in question. By so doing, defendant became free to produce its assembly without fear of litigation with plaintiff. When it procured the license from plaintiff, defendant bought its peace. That it would thus serve the interests of defendant, was undoubtedly its best judgment. About five years later one of defendant's officers took a different view and decided that defendant did not need and never had needed a license from plaintiff. Upon his determination of what was good for defendant then, as well as in 1948, defendant undertook to cancel an agreement which contained no express right of cancellation and which, by its terms, was not to expire until the expiration of the patent. The question as to whether defendant actually needed the license in 1948 was one for it to determine at that time. By its general counsel it expressed such determination in 1948, and, as a result, had freedom from litigation and the use of license rights for five years before someone in its organization decided, in effect that it had never needed a license from plaintiff. If a person decides

that he needs a brown hat and he thereupon goes to a store and buys it, pays for it and wears it, no one would make the absurd contention that he would have a right to refuse to pay for the hat, or, if he had already paid for it, to recover the purchase price from the store owner because he had since decided that he did not need the hat and had not needed it when he bought it. We cannot sustain the defense based upon the 1953 decision of one of defendant's officers that defendant never had any need for the license which it asked for and procured from plaintiff in 1948."

There are many cases to the same effect, some of them being as follows:

Washburn & Moen Mfg. Co. v. *Cincinnati Barbed-Wire Fence*, C.C.S.D. Ohio, 1884, 22 Fed. 712;

Dall Motor Parts Co. v. *Packard*, 1931, 124 Ohio St. 363, 178 N.Ed. 835, 12 U.S.P.Q. 185;

Eastern States Petroleum Co. v. *Universal Oil Co.*, 1938, 22 Del. Ch. 333, 2 A. 2d 138, 37 U.S.P.Q. 834;

Heller Inc. v. *Lassner Co.* (1st Dept. 1925), 214 App. Div. 315; 212 N.Y. Supp. 175;

Hazeltine Research v. *DeWald* (1st Dept. 1950), 276 App. Div. 1001, 95 N.Y.S. 2d 772; 85 U.S.P.Q. 222, reversing 84 N.Y.S. 2d 597, 79 U.S.P.Q. 446;

Jungersen v. *Morris Kaysen* (Pa. C.P. 1952), 95 U.S.P.Q. 162, aff'd 173 Pa. Super. 114, 97 U.S.P.Q. 244 (1953);

Hardwick v. *Gailbraith*, 147 Pa. 333;

Air King Products Co. v. *Hazeltine Research*, E.D. N.Y. 1950, 94 Fed. Supp. 85, 87 U.S.P.Q. 315.

The only cases which seem to depart from the well established rule that a nonexclusive licensee may not repudiate his contract by unilateral notice are *Universal Rim Co.* v. *Scott*, N.D. Ohio E.D., 1922, 21 F.2d 346, and *Vicki Hosiery* v. *Margulies*, E.D. Pa., 1958, 164 Fed. Supp. 738. Both of these District Court cases were considered by the Court of Appeals below, and the Court pointed out that the *Universal Rim* Case is complicated by the intervention of a receivership and the rights of the receiver with respect to an executory contract. The Court below characterized the *Vicki* Case as being a decision rendered during the pleading stage of the case and did not enter into any discussion with respect to the substantive law here in issue. It thus appears that the opinion of the Court below is completely consistent with an earlier decision of this Court and with Courts of Appeal for other circuits.

Petitioner refers to an apparent conflict of authorities on a somewhat related question but limited to exclusive licenses. Whether or not a licensee under an *exclusive* license may terminate the license agreement upon the assertion of invalidity of a patent seems by the cases to be in doubt, but conflict of authority with respect to *exclusive* licenses cannot be resolved by this petition since in this case only a *nonexclusive* license is involved. The Court below, as indicated earlier, was well aware of the difference in effect between a nonexclusive and an exclusive license.

If Petitioner's proposition of law is sound that a nonexclusive licensee, upon receiving an opinion from its patent lawyer that the licensed patent is invalid, may by notice terminate the license agreement, then certainly such a licensee may, upon an adjudicated holding of invalidity, terminate such a license. In the first instance, the invalidity is merely suggested but the actual fact is

in doubt. In the second case, the speculation has been somewhat removed by the formal court adjudication of invalidity. It has repeatedly been held that a formal adjudication of invalidity, in the absence of contract provisions to the contrary, does not excuse a licensee from the payment of royalties, and such adjudicated invalidity does not constitute a failure of consideration for the license.

Pope Mfg. Co. v. *Owsley* (C.C. N.D. Ill., 1886), 27 F. 100;
Hardwick v. *Gailbraith*, 147 Pa. 333;
Jungersen v. *Kaysen* (Pa. C.P. 1952), 95 U.S.P.Q. 162;
Lehman Co. v. *Appleton Toy & Furniture Co.*, (C.A. 7, 1945), 148 F.2d 988;
Hall Laboratories v. *National Aluminate Corp.*, 120 F. Supp. 684, 224 F.2d 303.

With the exception of the two District Court cases relied upon by Petitioner, which may be distinguished for the reasons given in the opinion of the Court of Appeals below, the law is uniformly established by this court, by the decisions of other courts of appeal, and followed by the decision below, that a nonexclusive licensee may not, in the absence of contract provisions to the contrary, repudiate and terminate by notice the license agreement and attempt to avoid the payment of royalties merely upon a suggestion that the licensed patent is invalid. It may not even do so where the patent has been formally adjudicated to be invalid.

2. THE OPINION BELOW IS NOT IN CONFLICT WITH APPLICABLE STATE LAW.

Petitioner urges that Section 1689 of the California Civil Code is pertinent to the present litigation, and that

the decision below is in conflict with this statute and with applicable California decisions. The provisions of the Code referred to by Petitioner are Sections 3 and 4, which permit termination of a contract if the consideration becomes void or fails in any material respect. This section of the California Code cannot be applicable to the agreement between the parties here because Petitioner has always received what it bargained for—the right to be freed from a suit for patent infringement.

The authorities hold that even an adjudication of invalidity of a patent is no basis for the nonpayment of royalties by a nonexclusive licensee, and that such adjudication does not work a failure of consideration to the nonexclusive licensee. This is for the reason that he was not bargaining for exclusivity.

Petitioner refers to the California case of *Armstrong* v. *Shell*, 98 Cal. App. 769. The opinion of the Court of Appeals below is not in conflict with this California case, because to the extent that the California case referred to the right of a licensee to repudiate a license the opinion was dicta; and, furthermore, as to this portion of the case one of the three judges specifically refused to concur and another of the three judges dissented from the whole of the opinion.

It is submitted that the later case of *Del Riccio et al.* v. *Photochart*, decided by the California District Court of Appeals in 1954, establishes the applicable California law, and is in harmony with the Court of Appeals below. In its opinion in the *Del Riccio* Case, the California District Court of Appeals stated:

> "• • • Appellant argues that this finding is directly contrary to the only evidence in the record relative to eviction, and which, it is contended, shows con-

clusively that after the aforesaid federal court decision, appellant's licensees refused to make payments for use of an invalidated patent, and that competitors were invading the field formerly denied to them. While it appears to be the law that where an *exclusive* license is granted and the patent is held invalid by the courts, the licensee may successfully claim an eviction, the argument is inapplicable where as here, the license is nonexclusive. * * *" (268 P. 2d 814)

There is thus no conflict with either the California statute or the applicable California law.

CONCLUSION.

It is suggested that the Court of Appeals below is in error in its opinion and that this Court should have an opportunity to correct such error. The decision of the Court below is in harmony with the *St. Paul Plow Works* case decided by this Court, and is in harmony with the opinions of other Courts of Appeal on the identical question. Independently of the numerous decisions establishing the law as followed by the Court below, reason dictates such a conclusion. It would violate fundamental legal concepts to permit a party to a license agreement to avoid the payment of royalties simply because of its assertion of invalidity of the patent under which it has a nonexclusive license. This is particularly true where the nonexclusive license agreement was entered into in settlement of prospective patent litigation.

By its agreement obtained after negotiation and at arm's length dealing, Petitioner acquired freedom from a suit for patent infringement at a price. It got, and still has, what it bargained for.

As stated in *Muth* v. *J. W. Speaker Corporation* (C.A. 7, 1959), 262 F.2d 797, 801:

> "Defendant throughout its brief suggests that it might be contrary to public policy to make it pay a royalty where others would make the same device without such payment. However, it is not definitely known whether another would make the device without running the risk of an infringement suit. The question apparently concerned defendant also and it led to the agreement in question. The defendant chose to buy immunity from lawsuits, justified or otherwise, at a certain price. It got just what it paid for. To allow defendant to renege on its agreement simply because it may now feel that it was overcautious would certainly be more incompatible with public policy."

The case below presents a simple question of contract law. It was decided correctly by the District Court and by the Court of Appeals in a decision which gives consideration to all of the arguments presented here by the Petitioner. There is presented in the petition no issue of major significance requiring the consideration of this Court.

Under these circumstances, it is urged that the petition for certiorari be denied.

Respectfully submitted,

THOMAS F. MCWILLIAMS,
Attorney for Respondent.

Chicago, Illinois
May 19, 1960